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MEMORANDUM FOR: Robert L. Harlow
Office of International Monetary Affairs

FROM :
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SUBJECT : East European Economic Outlook

1. Most of Eastern Europe has withstood the severe credit crunch that began in 1980 and peaked in early 1982. The regimes responded by imposing austerity, mostly in the form of cutting investment and imports. GNP growth for the region virtually stagnated in 1980-82, compared to annual growth in excess of 4 percent just a few years earlier. Domestic stabilization measures resulted in the intended improvements in the external accounts. The chronic hard currency current account deficits disappeared last year when the region ran a trade surplus of \$1.4 billion and a current account surplus of \$0.1 billion.

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2. The improvement in hard currency balances has continued in 1983. This year's trade surplus will rise to \$3.9 billion and the current account surplus to \$1.6 billion due mainly to reduced Yugoslav deficits. The continuing pressures for adjustment contributed to a further slowdown in GNP growth for most countries. The small revival of economic growth for Eastern Europe as a whole results largely from the pickup for Poland.

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3. Eastern Europe's external adjustment is beginning to produce some improvement in bankers' attitudes. The banks have stopped reducing their exposure to most countries and are even extending a few new credits to the more creditworthy regimes. Slight easing of the financial constraint should permit some reduction in the region's trade surplus in 1984. Lenders, nonetheless, remain cautious about increasing their exposure significantly. There is little prospect for a resolution of Poland's financial crisis, Yugoslavia will require more debt relief in 1984, and some bankers fear that Romania, Hungary, or East Germany may require rescheduling. As a result, the region

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will have to continue running payments surpluses. The East Europeans should be able to keep their current accounts in the black and achieve small gains in needed imports provided economic recovery in the West translates into increased East European exports. [redacted]

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4. Weathering the worst of the financial crisis does little to improve Eastern Europe's economic outlook. Resources will remain tight due to limited hard currency import capacity, possible further cuts in Soviet deliveries of energy and other raw materials, and sluggish growth in the industrial labor force. Productivity is dropping because of the loss of Western imports, investment cuts, falling living standards, and numerous systemic rigidities. GNP for the region is projected to grow at around 1 percent annually over the next several years. [redacted]

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TABLE 1

EASTERN EUROPE: Real GNP Growth Rates,
Actual 1981-1982 and Projected 1983-1984
(in percent)

	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
Eastern Europe	-0.6	-0.1	1.0	1.0
Bulgaria	3.0	2.8	1.5	2.0
Czechoslovakia	-1.1	0.5	1.0	1.0
East Germany	2.4	0.5	0.5	1.0
Hungary	0.4	1.7	0.5	0.5
Poland	-5.4	-4.0	1.5	1.5
Romania	0.6	2.7	1.0	1.0
Yugoslavia	1.5	0.3	-1.5	-1.5

NOTE: GNP estimates are based on Western concepts and procedures, with the exception of the data for Yugoslavia, which are Gross Social Product based on a material product concept of national income.

TABLE 1

EASTERN EUROPE: Hard Currency Current Account Balances
(Billion US\$)

	<u>1981</u>	<u>1982</u>	<u>1983^a</u>	<u>1984^a</u>
<u>Eastern Europe</u>				
Current Account	-5.5	0.1	1.6	2.2
Trade Account	-3.6	1.4	3.9	3.3
Invisibles and Transfers	-1.9	-1.3	-2.3	-1.1
<u>Bulgaria</u>				
Current Account	0.6	0.5	0.6	0.5
Trade Account	0.6	0.5	0.5	0.4
Invisibles and Transfers	0.0	0.0	0.1	0.1
<u>Czechoslovakia</u>				
Current Account	-0.1	0.2	0.6	0.6
Trade Account	0.3	0.5	0.8	0.8
Invisibles and Transfers	-0.4	-0.3	-0.2	-0.2
<u>East Germany</u>				
Current Account	-0.5	1.2	1.2	1.1
Trade Account	0.1	1.5	1.2	0.9
Invisibles and Transfers	-0.6	-0.3	0.0	0.2
<u>Hungary</u>				
Current Account	-0.7	-0.1	0.3	0.4
Trade Account	0.5	0.8	0.9	0.9
Invisibles and Transfers	-1.2	-0.9	-0.6	-0.5
<u>Poland</u>				
Current Account	-2.2	-1.0	-1.7	-1.5
Trade Account	-0.4	0.4	1.0	1.0
Invisibles and Transfers	-1.8	-1.4	-2.7	-2.5
<u>Romania</u>				
Current Account	-0.8	0.7	0.9	0.8
Trade Account	0.2	1.5	1.7	1.3
Invisibles and Transfers	-1.0	-0.8	-0.8	-0.5
<u>Yugoslavia</u>				
Current Account	-1.8	-1.4	-0.3	0.3
Trade Account	-4.9	-3.8	-2.2	-2.0
Invisibles and Transfers	3.1	2.4	1.9	2.3

^a Projected